channels; and (3) whether the system has 1,000 subscribers or more.[13/] These characteristics are among the most important in determining the costs incurred by a cable operator.

Benchmark classifications that followed this pattern would, consequently, meet the 1992 Cable Act's mandate for uncomplicated regulation while assuring that rates were reasonably related to the cost characteristics of each cable system.[14/]

b. Adjusting The Benchmarks.

Benchmarks, once established, must not be static. They must change in response to changes in the economic and regulatory environment in which basic cable service is provided. Thus, the Commission should establish adjustments to account for (1) inflation; (2) the costs for providing basic service that may be created by retransmission consent; and (3) the costs of any services or facilities required by franchising authorities or other governmental entities, including state cable commissions. Because most of these adjustments will be

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13/ In subsequent years other characteristics may need to be assessed, including the availability of non-buy-through pay services, since implementing technological changes to permit access to those services may dramatically affect the costs of basic service. Other factors may have statistical significance even today.

14/ In addition, using a cut-off of 1,000 subscribers would be consistent with the 1992 Cable Act's requirement that the Commission reduce the burdens of regulation on smaller cable systems, especially since it is likely that permitted per-channel rates for small cable systems would be higher than those for large systems. Thus, setting separate benchmarks for smaller systems would reduce the number of small systems that have to seek above-benchmark rates. *See Notice* at ¶ 128, 47 U.S.C. § 543(i).

individual to each cable system, the Commission should set initial benchmarks and then the individual benchmarks for regulated systems should vary automatically in accordance with these adjustments.[15/] The adjustments must also be designed to recover not just the direct costs of these changes, but the indirect costs and the opportunity costs, *i.e.* lost profits, from having to divert additional resources to these areas.

Inflation

Inflation is the one factor that will affect all cable operators and, consequently, the Commission should define a specific inflation adjustment. As was the case when the Commission adopted price cap regulation for common carriers, any inflation adjustment should be based on an easily-obtained, easy-to-understand index. For that reason, one of the national inflation indices calculated and disseminated by the Federal Government as its inflation adjustment is preferred.

As is the case for price caps, the Commission should adjust benchmarks for inflation once annually. Annual adjustments even out the fluctuations in inflation that occur from month to month and avoid the need for constant adjustments to calculations of permitted rates. More infrequent

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15/ In addition, however, unless non-basic benchmark levels also are adjusted accordingly, the Commission may find itself confronted by complaints over rate adjustments that would otherwise fall within benchmark levels were it not for the upward pressure on overall rates occasioned by changes in benchmark levels for basic services. This problem will be avoided where other adjustments to basic service benchmarks are automatically incorporated into those for non-basic services. *See* Part III(C), *infra.*

adjustments would seriously aggravate problems of regulatory lag that typically accompany most forms of rate regulation.

Retransmission Consent

Retransmission consent could also be an important, changing factor in the costs of providing basic cable service. Although the legality of the 1992 Cable Act's retransmission provision has yet to be determined, *see Turner Broadcasting System, Inc. v. F.C.C.*, No. 92-2247 (D.D.C.) (three judge court), it could have a significant impact on the costs of providing basic service if implemented. Because retransmission consent is a new obligation, the costs of obtaining consent have never been incorporated into the rates charged by cable systems. Whatever the parameters of retransmission consent arrangements,[16/] those costs must be factored into the rates charged for basic service. Failure to do so would, at best, discourage carriage of retransmission consent signals. A rate scheme that fails to account for a category of costs that will arise **only** because the Congress has specifically provided for the possibility of payment-for-carriage arrangements on basic service would be unreasonable. More importantly, designing a rate scheme which fails to take into account an operator's ability to earn a reasonable profit for that level of cable service would be confiscatory.[17/] Absent an accounting for these costs, cable operators would

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16/ The 1992 Cable Act directs the Commission to adopt rules governing the grant of retransmission consent that conform with the need to ensure that basic service rates are reasonable. *See* 47 U.S.C. § 325(b)(3)(A).

17/ *See* 47 U.S.C. § 543(b)(2)(C).

be faced with the choice of taking significant losses on the carriage of local broadcast channels or finding themselves unable to carry retransmission consent signals. Rate adjustments for all costs attendant to retransmission consent must be automatic.

Negotiated Changes

Finally, the Commission should adjust benchmarks to accommodate exceptions to basic service rate levels agreed to by cable operators and their franchising authorities. Cable operators and franchising authorities are permitted under the 1992 Cable Act to agree to more stringent (and, likely, more costly) customer service obligations or other services that are not envisioned under current rate structures.[18/] Clearly such costs, along with a reasonable return on those costs, must be reflected in basic rate increases beyond benchmark levels.[19/]

Negotiated adjustments could occur for several reasons. A franchising authority might wish a cable operator to take on new responsibilities, like taping and airing city council meetings and press briefings, that are not part

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18/ A comparable situation might arise where franchising authorities succeed in obtaining waivers of the federal rules on technical standards pursuant to Section 624(e) as amended by the 1992 Cable Act. *See* 47 U.S.C. § 544(e). Any more stringent standards or testing obligations may so increase operational costs as to warrant benchmark adjustments. Indeed, expenses accompanying implementation of the Commission's recently-adopted technical standards may warrant upward adjustments to even the initial application of benchmarks in some situations.

19/ If rates for basic service are to be kept at reasonable levels, the Commission must include in its regulatory parameters for basic service a clear directive to the cities that additional obligations impose new costs that must be borne by basic cable subscribers and, accordingly, that the cost implications of decisions to impose new burdens must be carefully considered.

of the original franchise agreement. While the cable operator might normally be agreeable to such changes, it might also find itself constrained from doing so by the limitation of its benchmark. Similarly, if new PEG channel requirements are imposed as part of a franchise renewal, the cable operator must be able to recover the new costs, including the underlying costs of capital, that those requirements create. Otherwise, it could find itself unable to continue existing services or programming because of those increased costs.

c. Adjusting Prices.

The 1992 Cable Act calls for the implementation of a pervasive regulatory scheme to govern the reasonableness of basic rates. Benchmarks define a level of presumptive reasonableness for basic rates, but they are not meant to operate to otherwise constrain cable operators in their ability to price and market cable services now or in the future. They cannot be expected to define, for example, how prices can change below the benchmark, especially in light of the new environment created by the 1992 Cable Act.[20/]

The 1992 Cable Act is likely, indeed intended, to change the way cable service is offered nationwide. The mandate for cost-based equipment prices, the emphasis on a low-cost basic service tier and many other aspects of

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20/ This reasoning is even more applicable to cable programming services, for which the dictates of the 1992 Cable Act are more jurisdictional in nature, leaving enormous room for Commission discretion in the identification and governance of unreasonable rates. Benchmarks in this context are to serve as indicators to assist the Commission in addressing complaints; they are not, even presumptively, a limit on what the cable operator can charge. *See* Part III(B), *infra*.

the 1992 Cable Act are going to require cable operators to adjust both the composition and the prices of many of the services they offer to subscribers. Against this backdrop of change, any rules that unreasonably limit cable operators' ability to price their services reasonably and to change prices to account for congressionally-mandated changes in service would be unfair and inappropriate.

Other changes in the market and in the regulatory environment might require comparable changes in the future. Cable operators that now offer basic service at particularly low prices to benefit senior citizens and the economically disadvantaged, for instance, might need to modify their practices significantly in response to current or future changes in the regulatory environment. Particularly low prices for some may remain appropriate, but other pricing practices may be warranted for basic subscribers generally.[21/] Limiting price changes for below-benchmark systems would prevent such legitimate reactions to changes in the marketplace. Consequently, the Commission should not adopt pricing rules that limit how much a cable operator can change its below-benchmark prices. "Banding" prices, an approach taken under the common carrier price cap rules, is particularly unsuited to a cable marketplace that is undergoing drastic change. Five or even ten percent limits on price changes will only hinder cable operators trying to comply with the new statutory

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21/ *See* 47 U.S.C. § 543(e)(1).

requirements.[22/] Banding also is an inappropriate regulatory choice because it will affect only cable operators whose rates are presumptively **not** unreasonable. While cable operators with rates above the benchmarks may be required to lower their rates in some circumstances, they will still be permitted in any event to charge rates at the benchmark levels. Under banding rules, some cable operators would not be permitted to charge rates at the benchmark levels simply because their past rates were **below** anything akin to an unreasonable rate level. There is no reason to assume that these operators will now act unreasonably just because of the existence of benchmarks, especially since they have had the opportunity to raise their rates to any level under the 1984 Cable Act and have chosen not to do so.[23/] In other words, banding would have the perverse effect of punishing those operators who have, for whatever reasons, maintained especially low rates.

Banding or other unnecessary restraints on price changes also could have a long term detrimental effect on the quality and diversity of cable service. The installation of fiber optics, addressability, high definition television, programming costs and other, unanticipated technological or market changes may require greater price changes than would be permitted by a banding scheme. Absent the ability to finance the equipment and other necessary expenses of improving service, cable television could be left unable to compete with new

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22/ The retiering that will result from the 1992 Cable Act also would make it difficult to determine whether a cable operator had complied with banding requirements for individual tiers.

23/ Of course, market forces also acted to constrain price increases over the last six years as well, and will continue to do so in the future.

technologies. The Commission can help to prevent this result by giving cable operators flexibility to adjust prices, so long as those prices remain below the benchmark.

3. There Must Be An Opportunity To Demonstrate That Above-Benchmark Basic Service Rates Are Reasonable.

Benchmarks provide the baseline for identifying cable rates that are presumptively reasonable. Higher rates also may be reasonable in certain circumstances. Cable operators must be given the opportunity to demonstrate that above-benchmark rates are reasonable, based on whatever evidence is appropriate to a particular case.

It is likely that, no matter how a benchmark is derived, its application in some situations will be inappropriate, or at least not indicative of the reasonableness of the rates charged. With an industry so technologically diverse as cable television, and individual marketplaces so dissimilar nationwide, the presence of anomalies is guaranteed. This predicament is all the more problematic because a pervasive regulatory scheme is being imposed on an industry that has been largely unregulated.

As the *Notice* explains, there is a substantial body of case law that prevents regulators from setting rates so low as to be confiscatory. *Notice* at ¶ 33, n.66. While these cases have arisen in the context of utility regulation, the principle remains the same, because the underlying right has nothing to do with the business being regulated. The basic question asked in any

takings case is whether the government, either directly or by regulation, has taken away the value of the property so regulated. *See, e.g., Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982) (taking occurs when regulation permitting physical invasion renders property unavailable); *Penn Central Trans. Co. v. City of New York*, 438 U.S. 104, 124 (1978) (holding that interference with investment-backed expectations is a factor in determining if a taking has occurred). Cable operators, no less than any other businesses, retain their right not to be deprived of their property.

To avoid inadvertent takings under the rate regulation provisions, the Commission must allow cable operators to charge above-benchmark rates where those rates are justified by the circumstances facing their cable systems. The Commission need not adopt detailed rules outlining what will justify above-benchmark rates. Instead, it should permit cable operators to justify those rates in any appropriate fashion. Among the justifications the Commission should consider are:

(1) Whether the geography or other attributes of the community make service more expensive;

(2) Whether the costs of expansion, rebuilds or upgrades affect the ability of the operator to provide service at below-benchmark rates;

(3) The effects of unusual franchise or state regulatory requirements on the system;

(4) Whether the overall costs of service, as demonstrated by the operator, require an above-benchmark rate;

(5) Increased capital costs; and

(6) Length of franchise.

The Commission also should particularly consider showings regarding customer service, because the 1992 Cable Act places a high priority on meeting customer needs. 47 U.S.C. § 552. Demonstrably excellent customer service, which is not without cost, and other proof of community service should be permitted to justify above-benchmark rates.

Permitting operators charging above-benchmark rates to justify those rates with any appropriate evidence also relieves the Commission of the burden of drafting detailed rules on this issue.[24/] Not only would drafting and justifying rules to cover most contingencies take a significant commitment of Commission resources, it is unlikely that any rules could cover all of the situations in which above-benchmark rates would be appropriate.

III. BENCHMARKING SHOULD BE USED IN THE COMMISSION'S OVERSIGHT OF CABLE PROGRAMMING SERVICES DIFFER.

Although certain differences between basic service and cable programming services, along with the goals of the 1992 Cable Act, mandate differences in how benchmarking can be applied to the two kinds of cable service, the Commission should adopt a benchmarking approach for the regulation of cable programming service. Applying the same type of regulatory regime is administratively efficient for regulators, consumers and cable operators.

24/ The Commission's rules should, however, reflect that cable operators have the right to charge above-benchmark rates upon a showing that those rates are justified.

Nevertheless, there must also be some differences in how benchmarking is applied to the two kinds of cable service. Some differences will be procedural, because of the differing roles of the Commission and franchising authorities under the statute. *See* Part III(B), *infra*. There also must be some substantive differences, so that the Commission can assure that cable operators have the wide flexibility necessary to meet their other obligations under the 1992 Cable Act.

A. Benchmarks Can Be Adopted To Cable Programming Services.

The Commission is required to consider different sets of criteria in deciding the best regulatory regimes for basic and cable programming services. Nonetheless (and for many of the same reasons) benchmarking regulation is appropriate for both.

Most notably, benchmarking conserves resources both for the Commission and for the cable operator. Avoiding unnecessary regulatory entanglements is particularly appropriate for cable programming services because of the complaint-driven nature of Congress' regulatory scheme. Benchmarks will allow prompt resolution of many, if not most, complaints when the operators' rates are at or below the appropriate benchmark levels. Similarly, the other advantages of benchmarks over cost-of-service regulation, ranging from enhancing flexibility to providing good incentives, apply equally to the regulation of basic services or cable programming services. *See* Part II(B), *supra*.

B. Benchmarks Must Reflect The Characteristics of Cable Programming Services.

While benchmarks can be adapted equally to both basic services and cable programming services, there are important differences between the two. As a consequence, benchmarks must be tailored specifically to cable programming service.

Most importantly, the benchmarks for basic service and for cable programming service serve different purposes. *Compare* 47 U.S.C. § 543(b) (basic service) *with* 47 U.S.C. § 543(c) (cable programming service). Basic rates are to be regulated directly. As described earlier, the benchmark sets the outer parameter: all rates at or below that level are reasonable and, therefore, lawful under the 1992 Cable Act. On the other hand, the Commission is not entitled to regulate rates for cable programming, *i.e.*, non-basic, non-pay services. Its role, rather, is to respond to complaints that some rates may be unreasonable. Benchmarking for these purposes is quite different. The 1992 Cable Act also requires the Commission to consider a wider range of factors when evaluating cable programming service rates.

Second, in order to accord cable operators the flexibility to respond to the market, the benchmark for cable programming services should be based on the overall price for both basic and cable programming services as well as installation, additional outlets and equipment rentals. In many of our systems, Cox currently includes the cost of the converter in the price for cable service in

the original outlet.[25/] Surveying the country to determine benchmarks with service and equipment priced separately would be difficult, arbitrary, and would not necessarily follow the intent of the 1992 Cable Act. One way to allow the operator to continue this practice and abide by the intent of the 1992 Cable would be to establish benchmarks based on the overall price of equipment and service for the cable programming service tiers.

One might envision a benchmark approach that reflects a level of service that corresponds to what most people take. One level of service might be cable programming service, a remote control, and a converter. A benchmark would be set based on what operators charge for this level of service. Another level of service, for which another benchmark would be determined, might include an additional outlet and the related equipment.

Following a packaging approach in the cable programming service level would allow for a more simplified definition of equipment cost in the basic level of service. This is consistent with the intent of the 1992 Cable Act by regulating the cable programming service level on a "not unreasonable" standard and maintaining administrative simplicity for the basic level of service.

Including basic services in the benchmark calculation for cable programming services will permit cable operators to have low-cost basic tiers without sacrificing their ability to provide high quality programming on cable

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25/ In fact, as Cox differs from system to system, the industry differs on the level of packaging based on the desires and characteristics of the local community.

programming service tiers. As discussed above, maintaining a low-cost basic tier is one of the goals identified by Congress. It was not Congress' intent, however, that overall cable service should be adversely affected. Nor should the Commission's regulations have the unintended effect of constraining cable operators' ability to provide the innovative, high quality services that have developed over the past decade. Variations in the scope and quality of services provided on basic will affect even further the pricing components for non-basic services. Congress evidenced a clear preference for shifting some expenses from basic to non-basic services.[26/]

Similarly, cable operators that provide installation and other services at prices lower than those permitted by rate regulations in order to reduce the cost of basic service should be permitted to recover those costs through their rates for cable programming service. Below-cost installation provides a positive benefit to the community because it makes it possible for more consumers to obtain cable service.[27/] Permitting cable operators to recover their lost revenue through their cable programming service revenues will create positive incentives to provide this benefit. The Commission also should assure that cable programming services benchmarks do not operate to constrain the

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26/ *See* H.R. Conf. Rep. No. 862, 102d Cong. 2d Sess. 63 (1922) ("Conference Report").

27/ For instance, Cox rarely prices installations at a level designed to recoup even their direct costs; free installations are often available under certain conditions.

operator's ability to package and market services to meet local subscriber needs, so long as overall rates do not rise to unreasonable levels.[28/]

C. Adjustments to Cable Programming Service Benchmarks Should Be Based On The Characteristics Of That Service.

Just as the Commission must tailor cable programming service benchmarks to account for the differences between basic and non-basic services, it also must assure that adjustments to cable programming service benchmarks account for the characteristics of that service. Some of the necessary adjustments will be the same as those applied to basic service, others will be pass-throughs of adjustments to basic service and some adjustments will be specific to cable programming service.

First, some of the adjustments like increases to reflect the added costs for retransmission consent, customer service and other changes approved or mandated by franchising authorities, should be incorporated directly into the cable programming service benchmark on a system-specific basis. It would make little sense to make allowances for these costs at the basic service level without also adjusting the cable programming services benchmark; the failure to do so would impede the cable operator's ability to recover these costs in the end.

28/ In addition, the Commission should not regulate the provision of audio services over cable television facilities. The market for the provision of audio services is highly competitive, and there is no evidence that it is necessary to impose any regulation whatsoever on these services. Bulk pricing and prices of services provided under contract to schools, institutions and multi-dwelling units also should not be regulated.

The benchmarks for cable programming service must also be adjusted to account for changes in costs that directly affect cable programming service. The most obvious of these are changes in the costs of obtaining programming. These costs should be passed directly through into the benchmark, with an additional margin to account for a reasonable profit.

It also is vital that benchmarks for cable programming service be adjusted to account for rebuilds, upgrades and system expansion. Improvements in cable service often come at considerable cost, in new equipment, new transmission facilities or other facilities. If cable operators are to continue the technological and other progress described in Part I, *supra*, they must be able to modernize and upgrade their facilities and to expand their facilities to serve areas that do not currently have cable service. Consequently, benchmarks should be adjusted to account for the costs of system expansion, rebuilds and upgrades[29/] and a reasonable return on those costs.

This adjustment should not consist merely of shifting an operator from one benchmark category to another if it constructs additional channels. Indeed, such a shift might actually penalize the operator for its new construction. Instead, the Commission should allow cable operators to increase their benchmarks when they have made capital expenditures. This adjustment should use a simple formula to prevent disputes over how much a benchmark should be

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29/ In this context, the term "upgrades" also includes new programming services that may become available.

permitted to increase and, for the reasons discussed above, a return on the investment should be included in the formula.

Once the adjustment is made, it should, like all other adjustments, become a permanent part of the operator's benchmark for that system. The adjustment, and its permanent nature, will help to create incentives for cable operators to continue the improvement and expansion of their cable systems, to the benefit of cable subscribers nationwide.

D. There Must Be An Opportunity To Show That Rates That Exceed The Cable Programming Service Benchmarks Are Not Unreasonable.

Benchmarks for cable programming service will serve, in large part, as a rough screen to determine when the Commission should inquire further regarding a complaint. Given this function, it is particularly important that the Commission give cable operators the discretion to show that above-benchmark rates for cable programming service are not unreasonable.

The Commission should consider a wide variety of factors in reviewing above-benchmark rates. Among the factors that should be considered are those listed in Part II(B)(3), above, including the geography of the community, unusual franchise requirements and unusually high capital costs. These factors affect both basic and cable programming service. The Commission also should consider factors that relate specifically to cable programming service, including in particular any substantial increases in programming costs, the costs

associated with rebuilds and the costs of new services being provided to cable subscribers.

The Commission also should give cable operators that use costing analysis the discretion to make those showings in any appropriate fashion. The Commission should accept cost sampling and other means of making reasonable approximations of the operator's costs. In no event should the Commission require detailed cost information of the kind that common carriers are typically required to provide. The burden of producing such information is much too great to be justified.

Thus, the Commission should adopt a benchmarking regime for rate regulation of both basic service and cable programming service. A benchmarking system designed in accordance with these comments will permit the Commission to achieve the goals of the 1992 Cable Act, assuring that rates are not unreasonable while preserving the flexibility of cable operators to respond to changes in the marketplace and technology. At the same time, benchmarking is simple enough that it can be implemented easily, at both the local and Federal levels. These attributes amply justify adopting benchmarking as the model for cable rate regulation.

IV. REGULATIONS OF PRICES FOR EQUIPMENT, INSTALLATION AND CHANGES IN SERVICE SHOULD BE SIMPLE AND SHOULD PROMOTE ACCESS TO BASIC SERVICE.

The 1992 Cable Act also mandates the regulation of prices for equipment, cable installation and changes in cable service.[30/] In general, these charges must be cost-based for the basic tier of service. *Notice* at ¶¶ 62, 74. The Commission, in designing its regulations for these rates, should be careful to assure that rates for equipment, installation and changes in service reflect all costs and include a reasonable profit. *See* 47 U.S.C. § 543(b)(2). The Commission also should adopt easily-understood regulations in order to lessen the burdens of regulation on cable operators, franchising authorities, the Commission itself and consumers generally.

A. Cable Equipment Charges Should Be Based On Average National Costs.

While the 1992 Cable Act mandates cost-based regulation for equipment, traditional cost-based regulation would be too complicated and too uncertain to justify its use for cable equipment. *See* Part II(A), *supra*. Instead, the Commission should base the rates for cable equipment on national averages, much like the benchmarks it should adopt for cable service.

The starting point for equipment regulation is to establish the types of equipment that are available. There are essentially four variations at this time: (1) regular converters; (2) regular converters with remote controls;

30/ 47 U.S.C. §§ 543(b)(3), (5).

(3) addressable converters; and (4) addressable converters with remote controls. To establish the cost-based rates for these variations, the Commission should survey equipment vendors to establish the average costs for each type of equipment, including freight charges and taxes.[31/] The average cost per converter should then be adjusted to account for (1) the non-return rate when service is disconnected; (2) the costs of repairing broken equipment; (3) inflation; (4) the cost of capital; and (5) a reasonable profit, as required by the statute. 47 U.S.C. § 543(b)(2). The total of the cost and these other factors should be divided by the useful life of the equipment to determine the benchmark rate.

This benchmark approach will permit cable companies and franchising authorities to know what the maximum charge for basic service tier equipment without elaborate, system-specific cost calculations. It also will assure that cable operators are able to recoup their actual costs for providing equipment, including indirect costs and a reasonable profit, as mandated by the statute.[32/]

31/ The Commission should establish several averages for each equipment type, since costs vary depending on the size of an order and other factors.

32/ Alternatively, if system-specific calculations are pursued, cost calculations must include: (1) the direct cost of, among other things, materials, fully-loaded labor, maintaining inventory, repair, purchasing, centralized fleet management, addressable equipment subscription fees, property tax, insurance, non-returned equipment, recovery of equipment and billing; and (2) indirect costs, including administration, audit fees, interest, internal accounting, legal fees and marketing.

B. The Commission Should Not Prevent Cable Operators From Offering Low-Cost Installation.

The provisions of the 1992 Cable Act require the Commission to adopt rules for cost-based pricing for installation of basic cable service, but do not specify the mechanism to achieve that goal. 47 U.S.C. § 543(b)(3). The Commission should allow cable operators the flexibility to charge promotional and other below-cost rates for cable installation, so as to preserve their ability to attract new customers and expand their businesses.[33/]

The best approach to meet the requirements of the 1992 Cable Act and to give cable operators flexibility is to set a ceiling for installation charges based on the total costs of installation plus a reasonable profit. The cable operator should be able to determine its own costs, based on the direct and indirect costs of installation, especially including any costs associated with customer service and assuring that installation is done according to the cable operator's quality of service standards.

Cable operators also should be permitted to distinguish between different types of installation, and to set higher prices for more difficult and costly installations if they so desire. If a cable operator decides to price different kinds of installation separately, each type of installation should have a separate price ceiling.

33/ As described in Part III(B), *supra*, cable operators should be permitted to recover their losses on below-cost installation through their rates for cable programming service.

C. Regulation Of Change Charges Should Be Limited To Changes That Affect Basic Service.

Finally, the Commission should limit its rate regulation rules for service changes to changes that affect basic service. Doing so is consistent with the requirements of the 1992 Cable Act and will prevent cable operators from bearing costs they should not bear.

As the *Notice* explains, the 1992 Cable Act requires that the basic tier regulations also include standards and procedures for changes in equipment or service tiers. *Notice* at ¶ 74. This requirement is directed only at the basic tier. Thus, the Commission is not required to adopt rules governing charges for changes among cable programming tiers or changes involving pay services.

Moreover, the Commission should not regulate the charges for changes in these other tiers of service. There are many circumstances in which these change charges are intended to recoup actual costs that a cable operator incurs. For instance, an operator may offer free installation to customers who purchase basic cable service and a pay channel. When it makes such an offer, the cable operator anticipates recouping the lost installation charges through its revenues from the cable services the customer purchases. If a customer takes advantage of this offer and then disconnects the pay channel after one month, a

change charge may be the operator's only way of recovering the installation costs.[34/]

This is only one of many circumstances when a change charge, even if not strictly "cost-based," is necessary in order to assure that the cable operator does in fact recoup its costs of providing service. The cost relationships in installing and changing service are indirect and complex, and cable operators set their charges at levels that recover their overall costs for these services, not the specific costs of installation or changes. The Commission should not interfere in these cost recovery mechanisms beyond the minimum requirements of the 1992 Cable Act.

V. THE COMMISSION SHOULD ADOPT FLEXIBLE LEASED ACCESS REGULATIONS.

A. Leased Access Benchmarks Should Set Maximum Prices.

The 1992 Cable Act also gives the Commission additional responsibilities for rate regulation of leased access services. *Notice* at ¶ 145. In order to assure that all of the requirements of the leased access provisions are met, the Commission should adopt a benchmark approach to leased access rate regulations, but permit variations from the benchmark under certain circumstances.

34/ Cellular telephone companies follow a similar pattern when they offer low-cost cellular telephones. Typically the low-cost offers require six month or one year service contracts. A customer who disconnects sooner often has to pay a large disconnection charge to the cellular carrier.

As a general rule, the benchmark that should be applied to leased access should be based on the benchmark rate for cable programming services for that system. At a minimum, the operator must be permitted to charge a monthly lease rate equivalent to its per-channel benchmark for cable programming services multiplied by the number of subscribers to the system. In addition, the operator must be able to claim some percentage of any advertising, sales or other revenue derived by the lessee.[35/]

This approach has the virtue of simplicity, and also reflects the reality of the cable operator's economic position. Any channel devoted to leased access is a channel that would have been available to the cable operator for revenue-producing programming. At the same time, a leased access channel carries many of the same costs as any other channel, plus additional costs related to the provision of leased access. The benchmark rate for cable programming services is a good proxy for the costs of the cable operator plus reasonable profits.[36/]

35/ Oftentimes cable programming agreements contain provisions for local advertising availabilities or other mechanisms whereby operators participate in the revenues generated.

36/ This normal maximum price should be subject to adjustment for services that create higher costs. For instance, cable operators should be permitted to establish higher rates for pay programming services or for programming that is likely to be offensive to subscribers. Pay programming will reduce the operator's revenues from its own pay services and offensive programming may cause subscribers to terminate cable service altogether.

Moreover, Section 612 mandates that leased access arrangements must not adversely affect the financial condition of the cable operator.[37/] In that context, a maximum rate that reflects the opportunity costs of giving up a channel is consistent with the statutory requirements.[38/]

The benchmark rate for leased access should apply only to the carriage of leased access programming. Billing and collection, studio services and other ancillary services impose additional costs on cable operators and should not be included in any benchmark. Rather, these services should be the subject of separate negotiations between the cable operator and the leased access programming provider.

This approach is consistent with the Commission's tentative conclusion that billing and collection services should be unbundled from the rates for leased access. *Notice* at ¶ 146. It also is consistent with the Commission's

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37/ *See* 47 U.S.C. § 532(c)(1). Although cable operators are not permitted to exercise editorial control over the programming of potential channel lessees, operators are empowered to consider content in establishing a reasonable price. Likewise, in setting maximum allowable prices the Commission must take cognizance of the impact that some programming could have on the "operation, financial condition, or market development of the cable system." *Id.* Leased channel programming that is "indecent" will be handled pursuant to Section 612(h) or (j), but there exists no other comparable statutory relief for the operator confronted by other forms of highly offensive programming. The required carriage of offensive leased access programming may well impact adversely subscribership to the system generally. Thus, maximum fees in these circumstances must be adequate to compensate the operator fully for any lost subscribers and general loss of goodwill in the community.

38/ Just as for benchmarks for basic service and cable programming service, a cable operator should have the opportunity to demonstrate that the benchmark for leased access services is too low. This is especially important in light of the mandate of Section 612(c)(1).